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World Economic and Social Survey 2012: In Search of New Development Finance

Overview

Summary

A perceived need for additional and more assured funding to address global development goals has led to a search for innovative sources of financing to complement traditional official development assistance. Recently, a number of innovative initiatives have been launched, particularly in the field of health, but these have not been major fundraisers. Other options with large fundraising potential have been proposed, including taxes on financial transactions and greenhouse gas emissions, as well as the issuance of special drawing rights of the International Monetary Fund to be leveraged as development financing.

The feasibility of these proposals depends mainly on securing the political agreement needed to implement them. Questions regarding the best ways to allocate the funds need to be addressed at the same time. Existing innovative development financing mechanisms earmark resources to specific purposes, such as for vaccination programmes designed to prevent the spread of contagious diseases. This has its advantages from a global public-goods perspective, but the international programmes are not always well aligned with national priorities and well-functioning of national institutions in developing countries.

The 2012 *World Economic and Social Survey* analyses these and other challenges. It confirms the potential of innovative development financing, but concludes that realizing this potential will require new types of international agreements and changes in global governance.

* E/2012/100.

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Innovative financing sources to meet global challenges

In 2001, a United Nations High-level Panel on Financing for Development, chaired by the former President of Mexico, Ernesto Zedillo, recommended a number of strategies for the mobilization of resources to fulfil the commitments made in the United Nations Millennium Declaration[1] to sustained development and poverty eradication.[2] The Panel concluded that substantial amounts of financial resources would be needed to achieve the international development goals. In addition, it made a strong case for tapping international sources of financing for the provisioning of global public goods, including for the prevention of contagious diseases, research for the development of vaccines and agricultural crops, combating climate change, and preservation of biodiversity. While there are no generally accepted estimates of the financing needs for meeting international development goals and global public goods, and while all such estimates are a matter of judgement, by any measure, needs tend to exceed, by far, the funds available for such purposes.

For many low-income countries, official development assistance (ODA) remains an important vehicle for financing development, given low levels of domestic savings and limited access to private capital flows. ODA has increased since the adoption of the Millennium Declaration, reaching $133 billion in 2011. Yet, flows would need to more than double in order to meet the long-standing United Nations target of 0.7 per cent of donor-country gross national income (GNI). Immediate prospects for meeting that target any time soon are grim, given fiscal pressures in donor countries. There are additional concerns that ODA has not been a very stable and reliable source of financing. The perceived need for additional and more assured funding has led to a search for innovative sources of development financing to complement traditional ODA.

Recently, a number of innovative financing initiatives have been launched. Many of these have been used to help finance new global health programmes and some to finance programmes for climate change mitigation and adaptation. The global health funds have immunized millions of children and distributed treatments for AIDS and tuberculosis to millions of people in the developing world. While international taxes (including a levy on air travel) have added to public funds for international cooperation, so far, these innovative mechanisms have not proved to be major fundraisers. In all, an estimated $5.8 billion in health financing and $2.6 billion in financing for climate and other environmental protection programmes have been managed through such mechanisms since 2002. The funds have been mobilized in part through "securitization" of existing ODA commitments which are not additional to traditional ODA. In fact, while difficult to estimate, probably only a few hundred million dollars have been added annually.

An array of other options with large fundraising potential have been proposed (see figure O.1 and table O.1), but have not been agreed upon internationally thus far. These include taxes on financial and currency transactions and on greenhouse gas emissions, as well as the creation of new international liquidity through issuance of special drawing rights (SDRs) by the International Monetary Fund (IMF), to be allocated with a bias favouring developing countries or leveraged as development financing. Though their potential may be high, these proposals are subject to

[1] See General Assembly resolution 55/2.

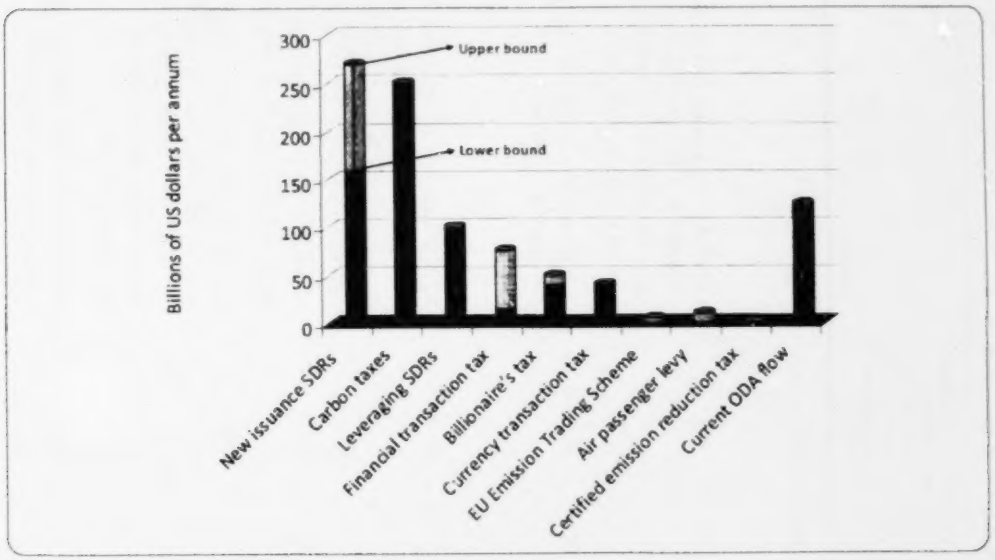
[2] See A/55/1000.

political controversy. For instance, many countries are not willing to support international forms of taxation, as these are said to undermine national sovereignty.

Figure O.1

The wide-ranging potential of (proposed and some existing) innovative sources of development finance

(Billions of United States dollars per annum)



Source: United Nations Department of Economic and Social Affairs.

Table O.1
Innovative sources of development finance and intermediation

	Description	*Current level of resources (billions of United States dollars per year)*	*Approximate potential revenue (billions of United States dollars per year)*	*Comment*
		New sources of finance		
Public sector revenue				
European Union Emission Trading Scheme (proceeds from initial allocations)	EU Governments auction: sell or allocate permits for emission allowances	0.2	1-5	Germany has agreed to allocate 15 per cent to international climate finance. The proportion for other countries is not specified. Financing is additional to existing ODA
Proceeds from certified emission reduction (CER) trading (2 per cent tax on new issuance)	2 per cent tax on CERs under the Clean Development Mechanism	0.06	0.06-0.75	Additional financing for climate adaptation in developing countries
Solidarity levy on airline taxes	Small tax levied on airline tickets, proceeds earmarked for UNITAID	0.2	1-10	$1.0 billion was raised from 2006 to 2010. Although financing is additional to existing ODA, it is still accounted for as ODA by Development Assistance Committee (DAC) members
Norway's tax on CO_2 emissions from aviation fuel	Tax on CO_2 emissions from aviation fuel in Norway	0.02	0.02	Norway contributes a portion of the proceeds of a tax on CO_2 emissions from aviation fuels to UNITAID
Carbon tax (proposal)	Tax on use of fossil fuels and other products contributing to CO_2 emissions	—	250	Assumes a tax of $25 per ton of CO_2 emissions by developed countries. Allocation of revenue for international climate financing would likely require an international agreement. Financing is additional to existing ODA
Currency transaction tax (CTT) (proposal)	Tiny tax on major currency foreign-exchange transactions	—	40	Assumes 0.005 per cent tax. Revenue would be additional to existing ODA

	Description	Current level of resources (billions of United States dollars per year)	Approximate potential revenue (billions of United States dollars per year)	Comment
Financial transaction tax (FTT) (proposal)	Tax on financial transactions, such as equity trades, bonds and derivatives includes CTTs	—	15-75 (excluding taxes on currencies)	A European Union FTT could raise €55 billion per year (excluding taxes on currencies) although it is unclear how much will go to development. Revenue would be additional to existing ODA
International billionaire's tax (proposal)	Tax of 1 per cent on individual wealth holdings of $1 billion or more	—	40-50	Proposal is not yet in any international agenda. Revenue would be additional to existing ODA
Capturing global resources				
New SDR issuance (proposal)	Regular annual allocations in favour of developing countries	—	160-270	Additional international liquidity would increase reserve availability and, consequently, is not a form of development financing
Leveraging SDRs (proposal)	Idle SDR holdings of reserve-rich countries are leveraged for investment in development	—	100	Assumes $100 billion annual allocations, which are leveraged 10 times. Depends on political willingness to leverage SDRs and technical design so as to preserve status of SDRs as reserve asset
Ownership of global resources (proposal)	Charge royalties for natural resource extraction beyond 100-mile exclusive economic zones	—	Unclear	Requires agreement on regimes for managing global commons, such as the International Seabed Authority. Revenue would be additional to existing ODA
	Intermediate financing mechanisms			
Mechanisms that restructure cash flows				
International Finance Facility for Immunisation (IFFIm)	Future aid flows securitized to front-load resources to finance GAVI Alliance	0.6	0.6	Between 2006 and 2011, IFFIm raised $3.6 billion on the basis of donor commitments of $6.3 billion. IFFIm restructures existing ODA and as a result is not additional

	Description	*Current level of resources (billions of United States dollars per year)*	*Approximate potential revenue (billions of United States dollars per year)*	*Comment*
Debt2Health	Donors grant debt relief in exchange for a commitment by the debtor to invest half of the debt relief in the Global Fund to Fight AIDS, Tuberculosis and Malaria	0.02	Limited scalability	Between 2007 and 2011, Debt2Health deals worth €163.6 million were concluded, one half of which countries contributed to the Global Fund. This is additional to existing ODA for countries that are current on their debt payments
Debt-for-nature swaps	Debt relief in exchange for local investments in the environment	0.05	Limited scalability	Has raised an estimated $1.1 billion-€1.5 billion since the late 1980s. This is additional to existing ODA for countries that are current on their debt payments
Mechanisms to manage risk				
Pilot advance market commitment for vaccines	Guaranteed future donor co-payments for vaccines	0.5	1.5 (committed)	Financing comes out of ODA budgets with a small amount of additional financing provided by the Gates Foundation
Affordable Medicines Facility-malaria (AMFm)	A subsidy to drug manufacturers of malaria therapies (artemisinin-based combination therapies (ACTs))	0.2	Limited scalability	About half the financing comes from UNITAID. Based on the composition of UNITAID financing, in total, half of AMFm financing is from traditional ODA, 40 per cent from innovative financing and 10 per cent from philanthropy
Caribbean Catastrophe Risk Insurance Facility (CCRIF)	A regional catastrophe insurance pool	0	0.068	Donor countries and the World Bank capitalized the insurance fund. Initial payments came out of ODA budgets
Mechanisms that leverage citizen or private sector resources				
Product Red	A brand licensed to private firms	0.04	Limited scalability	Raises funds for the Global Fund. Financing comes from participating companies and is additional to ODA

Source: *World Economic and Social Survey 2012: In Search of New Development Finance* (United Nations publication, forthcoming).

There are also challenges in the use and allocation of funds mobilized internationally. Most existing innovative financing mechanisms earmark resources upfront for specific purposes, as is the case for the global health funds. There are perceived benefits in doing so. Advocates argue that the earmarking helps build political support and attract funds by establishing a clear link between fundraising and popular causes. This may come at a cost, however, since earmarking funds can limit domestic policy space for channelling resources to nationally defined priorities.

The international community will need to come to grips with such issues if it wishes to go beyond traditional modalities of development assistance and meet the financing needs for addressing global challenges. *World Economic and Social Survey 2012* analyses the nature of the challenges associated with generating new sources of development finance. It confirms the potential of a number of mechanisms, but concludes that realizing that potential will require international agreement and corresponding political will to tap sources, as well as the design of appropriate governance of uses and allocation mechanisms.

What is innovative development financing?

A broad range of mechanisms may be regarded as constituting innovative development finance

There is no one set definition of innovative development finance. The Leading Group on Innovative Financing for Development describes it as comprising all mechanisms for raising funds for development that are complementary to official development assistance, predictable and stable, and closely linked to the idea of global public goods. According to the Leading Group, innovative development finance should be linked to the process of globalization, either through taxing sectors considered to have gained most from globalization, such as the financial sector, or by taxing global public "bads", such as carbon emissions.

The lack of a precise definition has caused many studies to offer a broad interpretation and consider all types of non-conventional forms of finance under the rubric of innovative development financing, ranging from the mechanisms mentioned earlier, such as securitization of ODA commitments, international taxes and new SDR allocations, to all kinds of "other innovations", such as local currency bonds and currency hedges, gross domestic product (GDP)-linked bonds, incentives to channel worker remittances to developmental investments and publicly guaranteed weather insurance mechanisms.

The present *World Economic and Social Survey* focuses on mechanisms that are relevant as international public finance

The present *Survey* discusses a more limited set of mechanisms falling within the realm of international public finance, that is, forms of financing directly supporting achievement of international development goals and provisioning of global public goods. Specifically, the *Survey* includes those mechanisms that share all the following characteristics: (a) official sector involvement, including the use of public sector resources, as well as arrangements in which official financing plays a

catalytic role in leveraging private sector and/or philanthropic resources; (b) international cooperation and cross-border transfer of resources to developing countries; and (c) innovation, in the sense that mechanisms are used in a new context or incorporate innovative features with respect to the type of resources or the way they are collected, or their governance structures. An additional desirable characteristic of the mechanisms considered is the capacity to generate additional development financing over and above existing ODA.

By this definition, most "other innovations" are not covered in this assessment. The definition does imply, however, that the assessment cannot be restricted exclusively to funding considerations. Funding, allocation and spending cannot be fully separated. As is the case in some existing mechanisms, the effective use of funds may influence availability. Several innovative financing mechanisms that channel resources to global health programmes, for instance, leverage future ODA commitments for more immediate disbursements tied to preventing specific communicable diseases.

The feasibility of new financing depends not only on sources, but also on how funds are channelled to end uses

Two main sources are considered: taxes levied on international transactions and/or taxes that are internationally concerted, such as the air-ticket solidarity levy, financial or currency transaction taxes and carbon taxes; and revenues from global resources, such as SDR allocations and proceeds derived from the extraction of resources from the global commons, through, for example, seabed mining in international waters. Proposals on potential sources of finance for international development cooperation in both categories have been discussed for decades, although most of these, with the exception of the proposal on an airline levy, have not yet been adopted.

Some innovations focus on intermediation mechanisms designed to better match funding and needs by facilitating front-loading of resources (which include several mechanisms channelling resources to global health funds and some debt-for-development swap mechanisms), by mobilizing public means to guarantee or insure natural disaster risks or technology development for public causes, or by securing specific-purpose voluntary contributions from the private sector for official development cooperation. Various mechanisms of these types do exist, but they are not large in size.

Several global funds that act as allocation mechanisms, are generally also considered to come under the rubric of innovative development financing. Disbursement mechanisms in the health sector include the Global Fund to Fight AIDS, Tuberculosis and Malaria, UNITAID and the GAVI Alliance. These mechanisms collect financing directly from sources or through intermediary financing mechanisms. UNITAID is the only disbursement mechanism that obtains the bulk of its financing from an innovative source, the air-ticket solidarity levy. Other funds rely mainly on traditional sources of financing.

To fully understand the potential of innovative development financing, it is important to examine its effectiveness in terms of the full flow of funds from their sources to the point of their actual disbursements for development.

Proposed sources of innovative development finance

The appeal of potential mechanisms for more automatic and assured flows of funds for international cooperation, especially if they can mobilize substantial amounts of resources, has led to multiple proposals on how to establish those mechanisms. While recognizing that these proposals have been long-standing, this *Survey* argues that certain forms of international taxation and leveraging of international reserve assets have great potential to significantly enhance resources for international development cooperation, warranting greater efforts to overcome the obstacles that have prevented tapping such potential in the past.

International reserve asset creation could boost finance for development and global public goods ...

In one such proposal, IMF would issue more international liquidity in the form of special drawing rights. Proposed annual allocations of SDR 150 billion-250 billion would be received mainly by developed countries, as the SDRs are distributed according to country quotas in IMF. However, if instead, two thirds were allocated to developing countries, they would receive $160 billion-$270 billion annually. The "seigniorage" from such issuance, which now accrues to the international reserve currency countries, could be allocated for use in part by the international community in favour of developing countries. Admittedly, changing the SDR allocation formula would constitute a significant political undertaking, as it will require an amendment to the IMF Articles of Agreement. Amending the Articles, like decisions for a general SDR allocation under existing rules, requires an 85 per cent approval of member votes, giving the United States of America an effective veto. Indeed, United States support for regular SDR allocations would imply a measure of global solidarity, as the seigniorage embodied in the new SDRs would be largely at the expense of seigniorage no longer accruing to the United States. Nevertheless, such a change could result in a significant strengthening of the international monetary system, which should be supported by all IMF member countries.

Such regular issuance of SDRs has no direct link to development finance, however. SDRs remain a reserve asset, but their additional availability, arranged through international coordination, could reduce the need for individual developing countries to set aside foreign-exchange earnings in reserve holdings of their own as a form of self-insurance against global market shocks.

... potentially yielding approximately $100 billion per year for international cooperation

An SDR allocation serves to create real purchasing power for the holder receiving the allocation. The question then is how to deploy that purchasing power for development or global public goods. It is estimated that over $100 billion per year of "idle" SDRs of reserve-rich countries could be converted into longer-term development finance. What is proposed is not to directly spend SDRs, but rather to float bonds backed by SDRs. In one proposal, a "Green climate fund" would issue $1 trillion in bonds, backed by $100 billion in SDR equity in a leverage ratio of 10 to 1. In another proposal, idle SDRs would be used to purchase bonds directly from

multilateral development banks. The Green climate fund (or global fund to fight climate change) could collect market-based interest payments from at least some borrowers, which it would then use to pay its bondholders. As low-income countries may not be able to afford such loans, the fund would also receive additional annual contributions from donors to enable it to underwrite its concessional activities.

The main concept underlying the proposal entails using SDRs to purchase long-term assets. The attraction resides in the ability to tap the large pool of "unused" SDRs, in order to invest them either for development purposes or, as in the above proposal, in equity shares in a Green climate fund. Through regular substantial SDR allocations, over $100 billion in development financing per year could be raised. An argument against this is that it would breach the very purpose of SDRs, which were created solely for transactions of a purely monetary nature. Leveraging them in such a way as to expose their holders to risks of illiquidity would distort the purpose for which they were created. The viability of the proposal may thus be seen to depend on how much risk would be involved and on designing the financial instrument for leveraging SDRs carefully enough to maintain its function as a reserve mechanism. The risks may be limited as long as the proposal is restricted to leveraging "idle" SDRs, which is similar to the existing practice of a fair number of countries of moving excess foreign currency reserves into sovereign wealth funds, where the liquidity and risk characteristics of specific assets in the fund determine whether or not those assets still qualify as reserve holdings.

An internationally concerted carbon tax could raise $250 billion per year ...

Discussion continues on the issue of appropriate policies for reducing greenhouse gas emissions and for mobilizing more automatic, assured and substantial additional flows to finance climate change mitigation and adaptation. The most straightforward approach to reducing emissions through financial incentives would be to impose a tax on carbon dioxide (CO_2) emissions so as to encourage economic actors to reduce the emissions under their control, through shifting, for example, to less carbon-emitting activities and energy sources. The price incentive should also stimulate increased output of more carbon-efficient products and services. However, there is little agreement on how much to tax, what to tax (fuels, for example, are not the only source of greenhouse gases), or whom to tax (should it be, for example, the final consumer or the producer of the greenhouse gases) and how to use the tax revenue that would be collected.

If global policy could be designed as if for a single economy, then a single global tax could be set (and adjusted over time) to steer overall emissions in the direction of a particular target to be achieved by a particular date. However, the world is made up of many countries which would experience different impacts on overall consumption and production from a single tax. The differential impact of a uniform carbon tax would cause objections to be raised by Governments and could frustrate agreement on the tax, especially since it is unlikely that those making the smallest sacrifices under a uniform tax would fully compensate those making the largest. Indeed, the 1997 Kyoto Protocol[3] to the 1992 United Nations Framework

[3] United Nations, *Treaty Series*, vol. 2303, No. 30822.

Convention on Climate Change[4] mandates only that higher-income countries make specific targeted reductions, as those countries are responsible for most of the man-made concentrations of CO_2 in the atmosphere and are best able to bear the economic burden. In this vein, a tax of $25 per ton of CO_2 emitted by developed countries is expected to raise $250 billion per year in global tax revenues. Such a tax would be in addition to taxes already imposed at the national level, as many Governments (of developing as well as developed countries) already tax carbon emissions, in some cases explicitly, and in other cases, indirectly through taxes on specific fuels.

Channelling the funds for international cooperation would require a separate political agreement, such as the 2009 Copenhagen Accord[5] through which developed countries promised to provide $30 billion over the period 2010-2012 (with pledges made so far coming close to that amount) and $100 billion per year by 2020 in new and additional resources to support climate mitigation and adaptation programmes in developing countries.[6]

... and a small currency transaction tax could add an estimated $40 billion ...

A tax on international currency transactions is deemed attractive principally because of the huge volume of daily transactions. While proponents assert that a very tiny tax would mobilize very substantial funds without materially affecting the market, opponents have argued that those that trade currencies work on very fine margins and that even a tiny tax would have a significant impact, as banks continually adjust their currency exposures. Proponents reply that technological advances and investments in the infrastructure of international payments over recent years have significantly reduced the cost of making financial transactions and that the proposed tax would reverse that reduction only minimally. Hence, while the currency transaction tax is broadly considered feasible, it might possibly reduce the earnings from such transactions.

A small tax of half a "basis point" (0.005 per cent) on all trading in the four major currencies (the dollar, euro, yen and pound sterling) might yield an estimated $40 billion per year. While the revenue may not be scalable by raising the tax rate because higher rates would affect trading volumes, even a low tax rate would limit high-frequency trading to some extent, it would thus result in the earning of a "double dividend" by helping reduce currency volatility and raising revenue for development. While a higher rate would limit trading to a greater extent, this might be at the expense of revenue.

... but in all cases, separate agreements would be needed on the use of the tax for international development cooperation

In all cases, the allocation of revenues for development would require a separate political agreement. One objection to a currency transaction tax arises from a fear

[4] Ibid., vol. 1771, No. 30822.

[5] See FCCC/CP/2009/11/Add.1, decision 2/CP.15.

[6] Ibid., decision 2/CP.15, para. 8.

that the financial institutions of a participating country would be at a disadvantage in global competition for financial business. Even though existing evidence from cases of implementation of such forms of taxation suggests that the fear may be unwarranted, the concern would be best overcome through adoption of the tax by international agreement. There should also be little reason for concern if the tax, as proposed, was imposed at a very low rate. The deeper problem, however, seems to lie in securing enough political support to earmark at least an agreed share of the proceeds for international development cooperation. Yet, the Group of Twenty has put the idea of an internationally concerted financial transaction tax in its agenda and agreed, at the Cannes Summit in November 2011, that new sources of funding need to be found over time to address development needs, which could include taxing the financial sector.

Existing sources of innovative financing for development

Recently developed mechanisms of "innovative development finance" are very different in nature. While limited in scale and tied to specific purposes, they have provided few resources additional to traditional ODA.

With the exception of two forms of international taxation (levies on air travel and a 2 per cent tax on transactions under the Clean Development Mechanism), existing mechanisms considered in the present analysis may be divided into three types: (a) mechanisms for transforming the time profile of development finance; (b) mechanisms for mitigating risk; and (c) mechanisms for harnessing voluntary private contributions.

Official development assistance can be effectively front-loaded

The principal aim of the first type is to secure financial resources for immediate use for development purposes. The International Finance Facility for Immunisation (IFFIm) is one such mechanism. It binds ODA commitments over a long period (6-23 years in practice) and securitizes those commitments to provide funds for immediate use by the GAVI Alliance. Debt conversion mechanisms, such as the Debt2Health scheme and debt-for-nature swaps, also fall within this category. Resources are freed up through cancellation of debts owed to bilateral creditors or by purchasing commercial bank debt at a discount on the secondary market. Part or all of the associated debt-service payments are redirected to a specific public use or non-governmental project, most commonly in the field of health or the environment.

These mechanisms have not mobilized additional funding; further, the amount of redirected resources has been modest by any measure. IFFIm has received donor commitments totalling $6.3 billion over a five-year period, generating a front-loaded fund of $3.6 billion, of which $1.9 billion has been disbursed since its establishment in 2006. Disbursements have been limited in part by the need for a very high level of liquidity to maintain creditworthiness. IFFIm disbursements will be offset in the long term by the diversion of ODA to service IFFIm bonds. The main benefit of these mechanisms clearly lies not in the raising of new resources, but rather in a more effective use of resources (see below).

Debt forgiveness to debt-distressed countries is not considered innovative development financing in this report, as it does not directly generate any new stream of financial resources. No systematic data on "debt-for-development" swaps is available. In the aggregate, the amount of resources generated through such mechanisms has been modest thus far. For instance, between 2007 and 2011, $119 million in resources was freed up through debt conversions for use by the Global Fund under the Debt2Health scheme.

Aid effectiveness can also be improved by guaranteeing and insuring risks

The second type of mechanism tries to secure funds to cover certain public-health and natural disaster risks through internationally arranged guarantees or insurance schemes. Under advance market commitments, which constitute one such scheme and are used mostly for disease prevention, ODA or funding from private philanthropic sources or both are utilized to guarantee a predetermined level of demand and prices for a particular technology-intensive good (such as pneumococcal vaccines) with a view to providing an assured market for producers so as to incentivize product development. Under the Affordable Medicines Facility — malaria (AMFm), a pilot scheme managed by the Global Fund to Fight AIDS, Tuberculosis and Malaria, lower prices are negotiated with producers of artemisinin-based combination therapies for malaria, in return for an assured market and a temporary subsidy, as a means of displacing older and less effective (but cheaper) alternatives from the market.

By the end of 2011, the pilot advance market commitment for pneumococcal vaccines had secured $1.5 billion in funding from bilateral and philanthropic sources, while the amount raised by the Affordable Medicines Facility — malaria was somewhat smaller, $312 million (including $180 million of financing, provided by UNITAID and sourced from the innovative air-ticket levy).

The Caribbean Catastrophe Risk Insurance Facility pools public finance risks arising from natural disasters, such as hurricanes and earthquakes. The Facility is capitalized by donors and allows members of the Caribbean Community (CARICOM) to collectively insure potential damages above a certain threshold level.

Innovative financing can be tapped by harnessing voluntary private contributions

Additional mechanisms seek voluntary contributions from private agents for defined purposes. Under one well-known scheme, Product Red, companies are licensed to use the brand for specific products in return for donating a share of the profits from these goods and services to the Global Fund to Fight AIDS, Tuberculosis and Malaria. MassiveGood (2010-2011), another — but short-lived — scheme, sought to raise funds for UNITAID, by securing small contributions from the purchase of tickets for air travel.

While it is only mechanisms in this category that provide resources additional to traditional (bilateral and private philanthropic) development finance, the amounts generated have been very limited. Product Red raised a total of $190 million in its

first five years of existence, while MassiveGood was cancelled after less than two years owing to disappointing results.

Existing mechanisms generate limited additional resources, but enhance aid effectiveness

While meaningful assessment is limited by their recent establishment, these mechanisms have generally served their respective purposes well. The International Finance Facility for Immunisation has front-loaded ODA resources effectively, keeping borrowing and administrative costs low. The pilot advance market commitment has accelerated the introduction of vaccines to fight pneumococcal disease (although still on a substantially more limited scale than originally envisaged). The preliminary results for the Affordable Medicines Facility — malaria appear broadly positive; and the Caribbean Catastrophe Risk Insurance Facility appears to be functioning effectively, having made several payouts, including to Haiti following the 2010 earthquake.

The potential for scaling up and replication needs to be tested

These mechanisms also have some potential for scaling up and/or replication for other uses. There are few technical limits to scaling up the International Finance Facility for Immunisation, although such scaling up is currently constrained by financial market conditions and fiscal pressure on aid budgets. Its application is also limited to contexts in which front-loading is appropriate, like vaccination programmes requiring quick expansion of coverage to be effective in containing the spread of diseases, or in cases where large indivisible investments are needed upfront to facilitate the diffusion of a new technology, such as renewable energy. Likewise, the advance market commitment for pneumococcal vaccines has some potential for use in other, similar contexts, although this is less clear in cases other than that of vaccines — cases, for example, where product specification is more complex, or cases involving the development of new technologies (as opposed to the commercialization of technologies already at an advanced stage of development). There may also be potential to replicate the Caribbean Catastrophe Risk Insurance Facility in some geographical contexts, which could be enhanced by risk-pooling through regional arrangements or multiregional arrangements so as to maximize the spread of risks.

In sum, these mechanisms may be able to meet specific needs, which is their principal aim. However, given their limited size and limited capacity to raise new funds, they do not contribute much, if anything, to closing the gap between current and projected levels of ODA and financial needs for development and global public goods.

Uses and global management of innovative development finance

Most of the resources raised to date under the rubric of innovative financing for development have been devoted to health. However, the expectation is that, in the

near future, substantial amounts of additional finance will become available for climate change mitigation and adaptation, which would be channelled through dedicated funds managing allocation for specific end uses.

In the area of global public health, most innovative financing resources have been used for control of communicable diseases, particularly diseases with global or wide geographical scope (HIV/AIDS, tuberculosis and malaria). In the area of climate finance, most initiatives focus on mobilizing resources for programmes for climate change mitigation, which have a clear global public-good nature, but few on addressing developing-country adaptation needs. Mitigation programmes account for about two thirds of the resources channelled through innovative financing mechanisms.

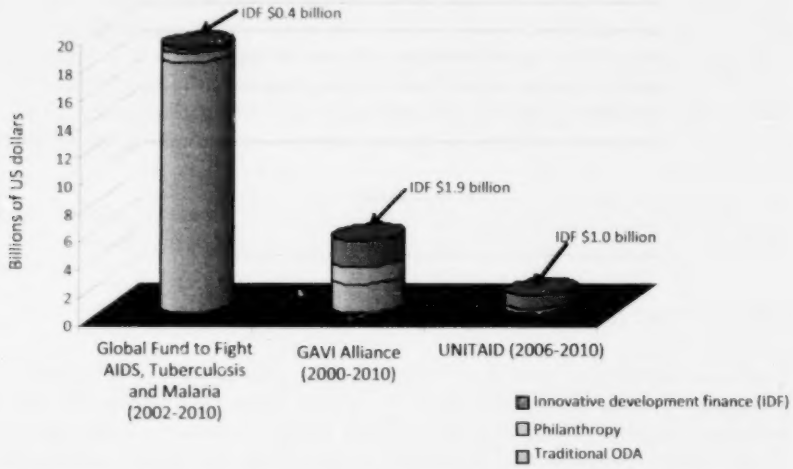
Overall, existing mechanisms tend to prioritize financing global public goods rather than supporting broader national-level development processes.

Global health funds are purpose-effective ...

Financing needs for health are considerable, and despite much greater priority attached to those needs by donors in recent years, a considerable gap remains between estimated needs and any realistic estimate of future ODA for health. The World Health Organization (WHO) estimates additional annual spending needed to achieve the Millennium Development Goals for health at $29 per person, implying a total increase in health spending in developing countries by $251 billion between 2009 and 2015. Financing the entire increase with domestic resources will be challenging for many low-income countries.

Innovative financing for health has largely passed through or funded programmes of the GAVI Alliance (the International Finance Facility for Immunisation and the advance market commitment for pneumococcal vaccines), the Global Fund to Fight AIDS, Tuberculosis and Malaria (the Affordable Medicines Facility — malaria, Debt2Health and Product Red) and UNITAID (figure O.2). While the International Finance Facility for Immunization has provided a substantial proportion (64 per cent) of GAVI funds since its inception in 2006, innovative financing mechanisms account for a much smaller proportion of Global Fund resources (2 per cent since 2002). Moreover, while both the GAVI Alliance and the Global Fund have been very successful in generating resources for carrying out their respective mandates, this success has lain primarily in attracting ODA, either directly or through innovative mechanisms: only the $190 million raised for the Global Fund by Product Red is additional to ODA. Only UNITAID is funded mainly by innovative sources, as 75 per cent of its resources come from air-travel levies.

Figure O.2
Only a small share of the financing of global health funds comes from additional innovative sources
(Billions of United States dollars, cumulative for period)



Source: *World Economic and Social Survey 2012: In Search of New Development Finance* (United Nations publication, forthcoming).

The GAVI Alliance and the Global Fund have generally performed well in respect of meeting their respective goals and have maintained reasonably stable and predictable levels of overall funding. The resource situation is potentially vulnerable, however, because of the heavy reliance of the Global Fund on bilateral funding and of the GAVI Alliance on the International Finance Facility for Immunization.

... but a case can be made for consolidating them under the Global Fund

More controversial is the set-up of global health funds as vertical (disease- or intervention-specific) funds. First, they do not directly help reduce health financing gaps as such, because the shortages primarily are in covering the cost of overall health services (medical personnel in particular) and do not mainly pertain to the cost of controlling specific diseases. Second, they may have adverse impacts on national health systems in recipient countries (see below). Third, they further fragment the aid architecture by adding new players and mechanisms.

While the issue of fragmentation arises primarily with respect to other bilateral and multilateral programmes, fragmentation in this case could be eased if most — if not all — vertical programmes were consolidated under the Global Fund. This would require that a broader health mandate be given to the Global Fund for which it is suited in view of the Fund's fairly inclusive and transparent governance structure. To deal with the second concern, greater efforts should be made to ensure that global funding for control of communicable diseases is adequately aligned with national policy priorities and that it strengthens — rather than weakens — national

health systems. As conceived, the Health System Strengthening Platform — established by the GAVI Alliance, the Global Fund and the World Bank — was to make an important step in this direction. Unfortunately, thus far, use of this Platform has been limited, partly owing to the reluctance of some of GAVI and Global Fund donors to go beyond current restrictive mandates, as well as the limited engagement of other donors. Overcoming these constraints will be critical. The fact that the existing mechanisms are not designed to address the first concern (continued financing gaps) would require seeking alternative funding mechanisms.

There is a growing potential for innovative climate financing ...

Estimates of additional financing needs for climate change mitigation and adaptation in developing countries are great — considerably greater even than those for health. Estimates of additional investment needs in 2030 are in the order of $140 billion-$175 billion per annum (plus additional upfront investments of $265 billion-$565 billion) for mitigation, and a further $30 billion-$100 billion per annum for adaptation. *World Economic and Social Survey 2011*[7] estimated additional investment needs of developing countries for sustainable development, including for climate change mitigation and adaptation, and for ensuring access to clean energy for all, sustainable food production and forest resource management, at about $1 trillion per year in the coming decades. As recognized, inter alia, by the Copenhagen Accord, from the perspective both of fair burden-sharing in financing global public goods and of the limited economic means of developing countries, a substantial share of the required financing would need to come from international transfers.

Innovative financing for climate change is still incipient, but it does have the potential to grow considerably in the coming years and could contribute significantly to fulfilling commitments made under the Copenhagen Accord. Total resources raised over the past decade through innovative financing mechanisms (excluding an unquantifiable amount of debt-for-nature swaps over the last 25 years) amount to a mere $1 billion, however: $168 million was raised by the Adaptation Fund, from a 2 per cent tax on transactions under the Clean Development Mechanism, and $841 million from Germany's auctions of permits under the EU Emission Trading Scheme, channelled through its International Climate Initiative. However, only a fraction ($20 million, all from the Adaptation Fund) has been disbursed so far, half of which was used to cover administrative costs.

Two mechanisms in particular are expected to generate substantial resources for climate change programmes in the next few years. First, from 2013, the European Union is to auction carbon emissions allowances, which will generate an estimated $20 billion-$35 billion in annual revenues; some countries have indicated their intention to allocate half for climate change programmes (although inasmuch as this includes domestic programmes, much less is likely to be devoted to programmes in developing countries). Germany is expected to channel 15 per cent of its revenue (or an estimated $500 million per year) to international climate-related programmes from 2013. If all European Union members do the same, over $5 billion per year would become available for international climate financing from auctioning European Union emission allowances.

[7] United Nations publication, Sales No. E.11.II.C.1.

Second, it is envisaged that the Reducing Emissions from Deforestation and Forest Degradation plus Conservation (REDD+ initiative), which has hitherto operated essentially as a coordinating mechanism for conventional multilateral and bilateral aid projects, should evolve into an innovative mechanism based on carbon trading.

... but existing climate financing mechanisms are highly fragmented

The minimal level of disbursements from the Adaptation Fund and the International Climate Initiative makes assessment of these mechanisms impossible. This is itself a source of concern. Climate funds more generally have been closely aligned with their goals and, in some cases, have been strongly results-oriented, while generally maintaining a commitment to country ownership. They also have the potential to provide stable and predictable levels of funding. An important caveat relates to uncertainty about the durability of many of these funds. As in the case of global health funds, the proliferation of climate funds in recent years has contributed to the fragmented nature of the international aid architecture.

Scaling up innovative financing will require governance changes to be effective

In order for innovative financing to contribute significantly to meeting the financing requirements for development and global public goods (including health and climate change mitigation and adaptation), it will need to be scaled up considerably in both areas and to shift towards mechanisms that generate additional resources, instead of merely front-loading or redirecting already committed official development finance. Replicating existing mechanisms, while maintaining the close link between the raising and the use of funds, would risk considerably compounding the proliferation of financing channels and the fragmentation of the aid architecture, particularly for climate financing.

This problem could be greatly eased by consolidating disbursement mechanisms for (traditional and innovative) development finance into fewer institutions characterized by broader but clearly defined mandates, close coordination among such mechanisms, and the pooling of resources from multiple (traditional and innovative) sources in each institution. It is also essential that governance structures for such programmes have a balanced representation of funding Governments and agencies, and recipients, and also ensure adequate accountability mechanisms.

In practice, it is unlikely that small-scale mechanisms, such as those developed to date, can fulfil more than a small fraction of financing needs. Together with the need to avoid further fragmentation of the aid architecture, this factor presents a strong case for larger-scale mechanisms that generate more substantial resources with greater flexibility in their use — for example, internationally coordinated taxes and SDR allocations. Such mechanisms, however, raise a number of issues for global economic governance. For instance, many countries are not willing to support international forms of taxation, as these are seen to compromise national sovereignty. It has, in the past, proved difficult to secure the necessary support for

SDR allocations. As indicated, in the absence of an amendment to the IMF Articles of Agreement, a very small share of such allocations accrue to low-income and least developed countries (3.2 per cent and 2.3 per cent, respectively). Orienting the resources raised for development would therefore require establishing additional financial mechanisms, for example, through creating trust funds or using SDRs to purchase bonds from multilateral development banks.

For the actual disbursement of funds, it would be best to avoid creating additional disbursement channels and to use existing ones instead (including the global fund for public health programmes and the Green climate fund which are being created), provided disbursements can be consolidated and channelled through fewer mechanisms with broader (for example, sector-wide) remits — again, with appropriate governance mechanisms to ensure full representation of recipients' interests.

Even if scaled up, the types of innovative development financing discussed here are unlikely to generate additional resources in the amounts needed to meet all financing needs for development and the provisioning of global public goods. Strengthening domestic resources will thus be crucial as well. International cooperation might also support such domestic efforts through international tax cooperation that would reduce tax avoidance and evasion.

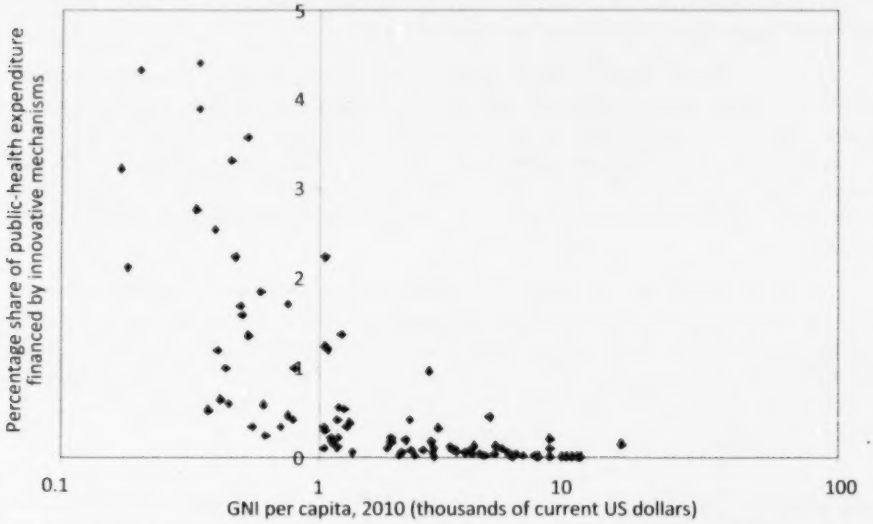
Managing innovative development finance at the national level

Assessment of the role of innovative financing in supporting development processes in recipient countries is difficult, in part because such financing tends to come with conventional financing. In any case, at the individual-country level, such financing thus far has been rather insignificant in macroeconomic terms and relative to sources of external financing, even in the poorest countries. Even in the health sector, where it is most developed, innovative development financing has not, as yet, reached a significant level relative to health expenditure (figure O.3). In only 12 very low-income countries (mostly in sub-Saharan Africa) do innovative financing mechanisms account for 2 per cent or more of public-health spending, and in no case does the figure exceed 4.4 per cent. In countries with income per capita of more than $1,200, the figure rarely exceeds 0.2 per cent.

Figure O.3

Innovative mechanisms finance a visible share of public-health expenditures only in a number of low-income countries

(GNI per capita against share of public-health expenditure funded by innovative financing mechanisms)



Sources: GAVI Alliance (http://www.gavialliance.org/results/disbursements/); Global Fund to Fight AIDS, Tuberculosis and Malaria (http://portfolio.theglobalfund.org/en/DataDownloads/Index); and World Development Indicators online database (available from http://databank.worldbank.org/ddp/home.do).

Aligning innovative development financing with national development strategies is essential

Global health funds are considered to have made significant contributions to disease control in recipient countries. Nonetheless, as indicated, these vertical funds have raised a number of aid-effectiveness concerns, particularly with regard to consistency with national ownership of development assistance as a result of insufficient alignment of externally funded programmes with national health strategies and inadequate embedding in national health systems during programme implementation. In some countries, especially those with limited institutional capacity and human resources, global health funds have drained human resources out of national health services and increased administrative burdens. At the same time, the fact that application for resources from the global funds is considered to be burdensome by a range of countries limits their access.

The challenges posed by vertical health funds have been recognized for decades. The funds have generally been justified as temporary means for achieving short-term results pending the development of effective health systems. However, health programme silos have become more widespread and tensions between silo programmes and national health systems remain. The limitations of the aforementioned Health System Strengthening Platform, as implemented, point to a missed opportunity to deal with this long-standing issue.

Country experiences in sub-Saharan Africa, Asia and Latin America and the Caribbean show that the relatively stable and predictable nature of resource availability from the global health funds does not necessarily translate into stable and predictable flows for individual recipients. Measurement issues aside, available evidence suggests that disbursements by both the Global Fund and the GAVI Alliance tend to be more volatile than traditional ODA flows. In a large number of countries, Global Fund and GAVI disbursements show sharp fluctuations from one year to the next.

The nature of the impact of innovative financing channelled through global climate and environmental funds, as a more recent phenomenon, has not yet become particularly discernible given the low disbursement rates to date. Embedding such financing in broader national sustainable development strategies is critical, given the cross-sectoral and economy-wide transformative changes that the investments are meant to engender.

Such concerns have raised doubts among recipient countries about the desirability of innovative development financing mechanisms. The fact that such mechanisms do not provide much additional finance but impose administrative burdens is a major concern. However, when a substantial scaling up of innovative development financing becomes politically feasible, recipient countries will need to prepare for adequate management of the much larger resource inflows, including by making them part of counter-cyclical macroeconomic management mechanisms and medium-term public expenditure programmes.

Global challenges, global solutions

To date, the promise of innovative development financing is, by and large, unfulfilled. Financing gaps remain large, especially with respect to supporting development, including achieving the Millennium Development Goals, and in providing global public goods, as for health and climate protection. Traditional mechanisms of official assistance are falling well short of what is required. The international community must recognize that it is in the common interest to provide stable and contractual resources for these purposes. Politically, tapping revenue from global resources and raising taxes internationally to address global problems are much more difficult than taxing for purely domestic purposes. But like all political decisions taken for the next generation and not just for the next election, this should be assessed carefully against alternative scenarios, including the very dangerous one of continuing polarization, exclusion, confrontation and insecurity in the world. The time has come to confront the challenge.